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Research Report

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The Structural Weaknesses of TTIP

Transatlantic Partnership Threatens More than Just Consumer Protection

Heribert Dieter

Questions concerning consumer rights have thus far dominated discussions about the planned Transatlantic Trade and Investment Partnership (TTIP). This is surprising, because very much more is at stake. Firstly, TTIP and similar large-scale projects endanger the future of the multilateral trading order. Secondly, before the agreement can be signed, enormous and as yet entirely unexplored obstacles will need to be overcome; this includes the question of inter-state dispute settlement. The economic benefits of TTIP will also be smaller than claimed, whereas the long-term political damage, especially for Germany, could be considerable.

Listening to the German debate over the planned trade partnership, one could be forgiven for concluding that protecting German consumers from the machinations of the US farming lobby was the most important issue in international economic relations. This one-sidedness in the discussion is dangerous, as TTIP in fact raises a whole series of discrepancies and problems, including fragmentation of the established trading order and American inconsistency in abandoning the international consensus on financial policy for new unilateral banking regulations. This contradiction has largely gone under the radar: while the United States and European Union negotiate harmonisation of product standards, new, diverging rules are created in financial market regulation.

Why No Progress in the Doha Round?

Before examining the weaknesses of TTIP, however, we must first consider why the WTO's Doha Round has failed to produce results. The proponents of a transatlantic partnership insist that the sluggishness of the Doha Round leaves no alternative to TTIP. Of course multilateral liberalisation is the ideal, they say, but it is impossible if the Doha partners are unable to reach a consensus.

But which countries are actually blocking progress? The World Trade Organization will name no names, but it is plainly a handful of states. Rather than the small developing countries, it is the United States and a number of emerging economies that stand in the way of a positive outcome.

Washington's negative stance is driven above all by domestic political considerations. In the United States there is no

longer broad support for further deepening of the international division of labour, and many US citizens have become very critical of globalisation. With opinion polls revealing great reservations about trade liberalisation, President Barack Obama has shied away from tackling the issue head-on. By advocating TTIP as a move to ensure “free and fair trade”, rather than a trade liberalisation project, he taps into widespread domestic concerns about “unfair” competition. In the 1980s many Americans regarded Japan as “unfair”, today China is usually the target.

This is where the first contradiction of TTIP appears. Why should the European Union, whose rhetoric commits it to an open, multilateral trading order, conclude such an agreement with the state that is blocking progress in the WTO?

Washington is, however, not solely responsible for backing the WTO into a corner. With hindsight, then Director-General Mike Moore’s decision in 2001 to label the Doha Round the “Doha Development Agenda” without consulting the trade ministers turned out to be extremely unfortunate. Moore created two fatal expectations: The developing and emerging economies now believed that this was “their” round, where they could expect far-reaching concessions from the OECD countries. Traditional supporters of trade liberalisation such as industry bodies in OECD states, on the other hand, were given the impression that the Doha Round was not serving their interests. They turned their backs on the WTO talks and concentrated instead on creating bilateral free trade areas.

In the meantime about 380 such preferential agreements have been signed and another 200, including TTIP, are in the pipeline. Although the WTO’s Ministerial Conference in Bali at the end of 2013 was able to agree a series of measures intended to ease trade, the organisation is still far removed from its past strength.

Overstated Economic Benefits

As with other trade proposals, TTIP’s advocates raise expectations that will be impossible to fulfil. This applies both to the expected effects on economic growth and to the predicted creation of new jobs. The central reason for this is that the negative repercussions of preferential agreements are not adequately taken into account.

The most important factor here is the role of certificates of origin. In return for the waiving of tariffs, companies must document the origin of their goods, which entails significant administrative costs. Especially for smaller and medium-size companies, the rules of origin generate burdensome administrative obstacles.

Astonishingly, this aspect plays virtually no role in the debates about TTIP, nor does it feature meaningfully in scholarly research. For example, a study prepared by the London-based Centre for Economic Policy Research (CEPR) on behalf of the European Commission does not even mention this question. The study includes no calculation of negative impacts. This is more than a mere oversight. The proponents of TTIP expect great economic benefits: CEPR calculates that it would increase the annual disposable income of the average European family by €545, and EU Trade Commissioner Karel de Gucht has repeatedly cited this figure in support of TTIP. In fact the economic gains are likely to be very much more modest than the elaborate forecasts of many researchers would suggest. The main reason for this is that the costs arising through documentation of origin remain unaccounted for. In other words, the savings arising through the abolition of tariffs have been calculated, but not the associated costs to businesses. That is plainly a grave weakness of the mathematical models. TTIP will therefore create very many fewer jobs than the published studies suggest, and the boost to economic growth will be considerably smaller.

Anti-Competitive Rules of Origin

The aforementioned problems stem partly from the very technical and complex nature of the issues involved. While preferential trade agreements facilitate commerce between participating economies, they certainly do not liberalise the entire foreign trade of the participating countries. If that were the objective, unilateral liberalisation would suffice. What countries concluding a preferential trade agreement want, on the other hand, is to prevent their external trade policy being undermined. That means restricting preferences to goods manufactured within the free trade area itself. Rules of origin serve to define the “nationality” of a product. At the same time, rules of origin can simply be bypassed through payment of the corresponding customs duty, dispensing with preferential treatment to avoid their trade-restrictive effect.

Where tariffs lie in the single-digit range, it may be easier or even cheaper for businesses to simply pay the duty rather than documenting origin. Considering that the cost of preparing certification of origin is estimated at about 5 percent of the value of the goods, while the average tariff on industrial goods in transatlantic trade is only about 3.5 percent, the possible economic benefits of TTIP are plainly relative.

Exclusion of China and Other Countries

Overestimated economic benefits are not the only question mark hanging over TTIP. The exclusion of China and other emerging economies from trade regulation processes is also an earnest problem. In this connection it is often argued that Washington and Brussels must make use of this last chance to lay down rules, before Beijing dictates the future rules governing international economic relations. The implied assumption that China is still willing to accept rules from whose formulation it has been excluded is quite unconvincing and ignores Beijing’s growing weight and confidence.

The new mega-regional trade projects pushed by the European Union and the United States not only weaken the WTO, but also betray their own principles. The multilateral trading order shaped after 1945 by the United States, later joined by Europe, aimed primarily at overcoming the trade discrimination of the inter-war years. The heart of the 1947 General Agreement on Tariffs and Trade (GATT), the most favoured nation principle (Article 1), was a masterstroke not only from an economic perspective, but also in terms of stabilising international relations. At least for the countries participating in the agreement, this overcame the distinction between friend and foe that had crippled foreign trade during the 1930s.

In view of these historical experiences there is no comprehensible reason to ditch the multilateral trading order. The European Union and the United States cannot prevent China’s continuing rise – but they can ensure that international trade is conducted within a system of rules that they themselves have shaped.

The Dispute Settlement Problem

Yet another problem of the TTIP is dispute settlement between individual states. The WTO’s dispute mechanisms are almost unanimously regarded as valuable and successful. They permit countries, however small or large, to have the trade policies of other states scrutinised. The European Union and the United States have frequently pursued complaints in this framework, for example in the dispute over Boeing and Airbus. But how should future disputes be settled? Should TTIP have its own court of settlement? And why should Europeans and Americans now be able to agree on conflicts that they were unable to resolve in the past even with the help of dispute settlement mechanisms? It would appear naive to expect expedited dispute settlement between the United States and the European Union without the help of the WTO.

Contradictory American Moves

The latest US initiatives to regulate the financial markets also raise questions. While US Trade Representative Michael Froman never tires of preaching the benefits of harmonising standards for trade in goods, US financial regulators are moving in the opposite direction. In 2014 Washington abandoned the principle of home-country regulation in finance, under which for example Deutsche Bank was regulated in Frankfurt, and only in Frankfurt. Banking supervisors in the United States did not evaluate the adequacy of risk assessment models used by Deutsche Bank and other foreign banks, nor did they request foreign banks to hold core capital in the United States. In future, however, foreign banks operating in the United States will also be regulated by the US authorities (host-country regulation) and will have to hold capital there, too. While there is certainly room to debate the pros and cons of such a “Balkanization of finance” (*The Economist*), the trend certainly jars with the spirit of a single transatlantic economic space.

Deutsche Bank and the French BNP Paribas are currently facing huge US demands. BNP has been fined \$8.9 billion for violating US sanctions against Iran and other countries. Paris has sharply criticised this measure and sees France’s sovereignty threatened. And indeed, BNP is not reported to have violated any French laws.

discrimination creeping back into trade policy could generate growing conflicts in the new multipolar world order. Here geopolitics is undermining a liberal consensus in trade policy that has lasted since the end of the Second World War.

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Small Benefit, Great Harm

There are thus many reasons to question TTIP. Preferential trade agreements, which make international trade more complex and less transparent, do most harm to medium-sized companies, also in Germany. TTIP and other “mega-regionals” are especially problematic, as they possess little in the way of economic justification. These new initiatives serve geopolitical as well as economic objectives.

Politicians are increasingly turning away from the economic ideal of multilateral regulation and trade liberalisation. Instead,